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Omnibus Statement on Auditing Standards—1987

The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report

(Supersedes Statement on Auditing Standards No. 5, AICPA, Professional Standards, vol. 1, AU sec. 411.05–411.08.)*

1. This amendment replaces paragraphs 5 through 8 with new paragraphs 5 through 8 and recognizes the following as part of the sources of established accounting principles: (a) within category [a], statements and interpretations issued by the GASB for financial statements of state and local governmental entities; (b) within category [b], technical bulletins issued by the GASB; and (c) within category [d], AcSEC practice bulletins and minutes of the FASB Emerging Issues Task Force.

*This Statement also withdraws the auditing interpretation dated December 1984 titled "The Auditor's Consideration of Accounting Principles Promulgated by the Governmental Accounting Standards Board" (AICPA, *Professional Standards*, vol. 1, AU sec. 9411).

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5. Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are experts in those accounting principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles are generally the following:

- a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 (ET section 203.01) of the AICPA *Code of Professional Conduct*
- b. Pronouncements of bodies composed of expert accountants that follow a due process procedure, including broad distribution of proposed accounting principles for public comment, for the intended purpose of establishing accounting principles or describing existing practices that are generally accepted
- c. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application to specific circumstances of pronouncements that are generally accepted
- d. Other accounting literature

6. Category (a), officially established accounting principles, includes Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards, FASB Interpretations, Accounting Principles Board (APB) Opinions, AICPA Accounting Research Bulletins and, for financial statements of state and local governmental entities, statements and interpretations of the Governmental Accounting Standards Board (GASB).⁴ If, for a state or local governmental entity, the accounting treatment of a transaction or event is not specified by a pronouncement of the GASB, applicable pronouncements of the FASB are presumed to apply. Rule 203 (ET section 203.01) provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 (ET section 203.01) implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Interpretation 203-1 (ET section 203.02) of the AICPA *Code of Professional Conduct* states, "There is a strong presumption that adherence to officially established accounting principles would in nearly all

⁴Some of these pronouncements have been superseded or amended by other pronouncements of both the APB and the FASB, and, in the future, they may be superseded or amended by pronouncements of an authoritative body pursuant to rule 203 (ET section 203.01).

instances result in financial statements that are not misleading.” Nevertheless, rule 203 (ET section 203.01) provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. When the unusual circumstances contemplated by rule 203 (ET section 203.01) exist and the statements depart from a pronouncement, the auditor’s report should present, in a separate paragraph or paragraphs, the information required by rule 203 (ET section 203.01), including a description of the departure, its approximate effects (if practicable), and the reasons why the departure is necessary to prevent the financial statements from being misleading. In those circumstances, however, unless there are reasons other than the departure to modify his opinion, the auditor should express an unqualified opinion on conformity with generally accepted accounting principles.

7. If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 (ET section 203.01), the auditor should consider whether the accounting treatment is specified by another source of established accounting principles. Categories (b) and (c) are both sources of established accounting principles. Category (b) includes AICPA Industry Audit and Accounting Guides, AICPA Statements of Position, and Technical Bulletins issued by the FASB or GASB; category (c) includes AICPA Accounting Interpretations, as well as practices that are widely recognized and prevalent in the industry. If an established accounting principle from one or more sources in category (b) or (c) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between sources within those categories, the auditor should consider which treatment better presents the substance of the transaction in the circumstances.

8. In the absence of a pronouncement covered by rule 203 (ET section 203.01) or another source of established accounting principles, the auditor may consider other accounting literature, depending on its relevance in the circumstances.⁵ Other accounting literature includes, for example, APB Statements, AICPA Issues Papers, AcSEC Practice Bulletins, minutes of the FASB Emerging Issues Task Force, FASB Statements of Financial Accounting Concepts, Concepts Statements of the GASB, International Accounting Standards Committee Statements of International Accounting Standards, pronouncements of other profes-

⁵ The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. SAS No. 1, *Lack of Conformity With Generally Accepted Accounting Principles* (AICPA, *Professional Standards*, vol. 1, AU sec. 544.04), and SAS No. 14, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 621), provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

sional associations or regulatory agencies, and accounting textbooks and articles. The appropriateness of other accounting literature as a source of established accounting principles depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than accounting textbooks or articles.

Required Supplementary Information

(Supersedes Statement on Auditing Standards No. 27, AICPA, Professional Standards, vol. 1, AU sec. 553.)*

2. This amendment (a) recognizes supplementary information required by the GASB; (b) reflects changes due to the issuance of FASB Statement No. 89, *Financial Reporting and Changing Prices*, which rescinds the requirement to disclose supplementary information on the effects of changing prices; (c) clarifies the guidance to follow when an entity voluntarily presents supplementary information not required by the FASB or GASB; (d) provides reporting guidance when the auditor is unable to remove substantial doubts about whether the supplementary information conforms to FASB or GASB guidelines; and (e) eliminates paragraph 11 of SAS No. 27 which discusses issues no longer being considered by the Auditing Standards Board regarding exception reporting.

1. The Financial Accounting Standards Board (FASB) and Governmental Accounting Standards Board (GASB) develop standards for financial reporting, including standards for financial statements and for

* This Statement also withdraws the following Statements on Auditing Standards:

- Statement on Auditing Standards No. 28, *Supplementary Information on the Effects of Changing Prices*, AICPA, *Professional Standards*, vol. 1, AU sec. 554.
- Statement on Auditing Standards No. 40, *Supplementary Mineral Reserve Information*, AICPA, *Professional Standards*, vol. 1, AU sec. 556.
- Statement on Auditing Standards No. 45, *Supplementary Oil and Gas Reserve Information*, AICPA, *Professional Standards*, vol. 1, AU sec. 557.

SAS No. 45 will be reissued as an auditing interpretation.

certain other information supplementary to financial statements.¹ This section provides the independent auditor with guidance on the nature of procedures to be applied to supplementary information required by the FASB or GASB, and describes the circumstances that would require the auditor to report such information.

Applicability

2. This section is applicable in an audit in accordance with generally accepted auditing standards of financial statements included in a document that should contain supplementary information required by the FASB or GASB. However, this section is not applicable if the auditor has been engaged to audit such supplementary information.²

3. Some entities may voluntarily include, in documents containing audited financial statements, certain supplementary information that is

¹ The FASB and GASB's roles in setting standards for financial reporting have been recognized by the AICPA Council. The FASB's authority to establish standards for disclosure of financial information outside of the basic financial statements is described in the following resolution:

That as of (September 19, 1987), the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this Council as the body to establish accounting principles pursuant to rule 203 and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 of the *Rules of the Code of Professional Conduct* of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by Council as contemplated in rule 203 of the *Rules of the Code of Professional Conduct* unless and until such time as they are expressly superseded by action of the FASB.

The GASB's authority to establish standards for financial reporting is described in the following resolution:

That as of (September 19, 1987), the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently in accordance with its rules of procedure and the bylaws of the FASB, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203, and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202.

² This section is not applicable to entities that voluntarily present supplementary information not required by the FASB or GASB. For example, entities that voluntarily present supplementary information on the effects of inflation and changes in specific prices, formerly required by FASB Statement No. 33, *Financial Reporting and Changing Prices*, are guided by SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550).

required of other entities. When an entity voluntarily includes such information as a supplement to the financial statements or in an unaudited note to the financial statements, the provisions of this section are applicable unless either the entity indicates that the auditor has not applied the procedures described in this section or the auditor includes in an explanatory paragraph in his report on the audited financial statements a disclaimer on the information.³ The following is an example of a disclaimer an auditor might use in these circumstances:

The [identify the supplementary information] on page XX (or in Note XX) is not a required part of the basic financial statements, and we did not audit or apply limited procedures to such information and do not express any assurances on such information.

When the auditor does not apply the procedures described in this section to a voluntary presentation of required supplementary information required for other entities, the provisions of SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), apply.

Involvement With Information Outside Financial Statements

4. The objective of an audit of financial statements in accordance with generally accepted auditing standards is the expression of an opinion on such statements. The auditor has no responsibility to audit information outside the basic financial statements in accordance with generally accepted auditing standards. However, the auditor does have certain responsibilities with respect to information outside the financial statements. The nature of the auditor's responsibility varies with the nature of both the information and the document containing the financial statements.

5. The auditor's responsibility for other information not required by the FASB or GASB but included in certain annual reports—which are client-prepared documents⁴—is specified in SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550). The auditor's responsibility for information outside the basic financial statements in documents that the auditor submits to the client or to others is specified in SAS No. 29, *Reporting on Information Accompanying the Basic Financial*

³ When supplementary information is presented in an auditor-submitted document outside the basic financial statements, the guidance in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), as amended by this Omnibus Statement, should be followed.

⁴ Client-prepared documents include financial reports prepared by the client but merely reproduced by the auditor on the client's behalf.

Statements in Auditor-Submitted Documents (AICPA, *Professional Standards*, vol. 1, AU sec. 551). The auditor's responsibility for supplementary information required by the FASB or GASB (called *required supplementary information*) is discussed in the paragraphs that follow.

Involvement With Required Supplementary Information

6. Required supplementary information differs from other types of information outside the basic financial statements because the FASB or GASB considers the information an essential part of the financial reporting of certain entities and because authoritative guidelines for the measurement and presentation of the information have been established. Accordingly, the auditor should apply certain limited procedures to required supplementary information and should report deficiencies in, or the omission of, such information.

Procedures

7. The auditor should consider whether supplementary information is required by the FASB or GASB in the circumstances. If supplementary information is required, the auditor ordinarily should apply the following procedures to the information.⁵

- a. Inquire of management about the methods of preparing the information, including (1) whether it is measured and presented within prescribed guidelines, (2) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and (3) any significant assumptions or interpretations underlying the measurement or presentation.
- b. Compare the information for consistency with (1) management's responses to the foregoing inquiries, (2) audited financial statements,⁶ and (3) other knowledge obtained during the examination of the financial statements.

⁵ These procedures are also appropriate when the auditor is involved with voluntary presentations of such information required for other entities (see paragraph 3).

⁶ GASB Statement No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers*, requires presentation of certain 10-year historical trend information relating to pension activities as supplementary information outside the basic financial statements. Such information is generally derived from financial statements. If such required supplementary information has been derived from audited financial statements and is presented outside the basic financial statements in an auditor-submitted document, the auditor may report on this information as indicated in SAS No. 42, *Reporting on Condensed Financial Statements and Selected Financial Data*, paragraph 10 (AICPA, *Professional Standards*, vol. 1, AU sec. 552.10).

- c. Consider whether representations on required supplementary information should be included in specific written representations obtained from management (SAS No. 19, *Client Representations* [AICPA, *Professional Standards*, vol. 1, AU sec. 333]).
- d. Apply additional procedures, if any, that other statements, interpretations, guides, or statements of position prescribe for specific types of required supplementary information.
- e. Make additional inquiries if application of the foregoing procedures causes the auditor to believe that the information may not be measured or presented within applicable guidelines.

Circumstances Requiring Reporting on Required Supplementary Information

8. Since the supplementary information is not audited and is not a required part of the basic financial statements, the auditor need not add an explanatory paragraph to his report on the audited financial statements to refer to the supplementary information or to his limited procedures, except in any of the following circumstances:⁷ (a) the supplementary information that the FASB or GASB requires to be presented in the circumstances is omitted; (b) the auditor has concluded that the measurement or presentation of the supplementary information departs materially from prescribed guidelines; (c) the auditor is unable to complete the prescribed procedures; (d) the auditor is unable to remove substantial doubts about whether the supplementary information conforms to prescribed guidelines. Since the required supplementary information does not change the standards of financial accounting and reporting used for the preparation of the entity's basic financial statements, the circumstances described above do not affect the auditor's opinion on the fairness of presentation of such financial statements in conformity with generally accepted accounting principles. Furthermore, the auditor need not present the supplementary information if it is omitted by the entity. The following are examples of additional explanatory paragraphs an auditor might use in these circumstances.

Omission of Required Supplementary Information

The (Company or Governmental Unit) has not presented [*describe the supplementary information required by the FASB or GASB in the circumstances*] that the (Financial or Governmental) Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

⁷ When required supplementary information is presented outside the basic financial statements in an auditor-submitted document, the auditor should disclaim an opinion on the information unless he has been engaged to examine and express an opinion on it (see SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* [AICPA, *Professional Standards*, vol. 1, AU sec. 551.15]).

Material Departures From Guidelines

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the [*specifically identify the supplementary information*] is not in conformity with guidelines established by the (Financial or Governmental) Accounting Standards Board because [*describe the material departure(s) from the FASB or GASB guidelines*].

Prescribed Procedures Not Completed

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because [*state the reasons*].

Unresolved Doubts About Adherence to Guidelines

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures prescribed by professional standards that raised doubts that we were unable to resolve regarding whether material modifications should be made to the information for it to conform with guidelines established by the (Financial or Governmental) Accounting Standards Board. [*The auditor should consider including in his report the reason(s) he was unable to resolve his substantial doubts.*]

Even though he is unable to complete the prescribed procedures, if, on the basis of facts known to him, the auditor concludes that the supplementary information has not been measured or presented within prescribed guidelines, he should suggest appropriate revision; failing that, he should describe the nature of any material departure(s) in his report.

9. If the entity includes with the supplementary information an indication that the auditor performed any procedures regarding the information without also indicating that the auditor does not express an opinion on the information presented, the auditor's report on the audited financial statements should be expanded to include a disclaimer on the information.

10. Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB or GASB. However, management may choose not to place the required supplementary information outside the basic financial statements. In such circumstances, the information should be clearly marked as unaudited. If the information is not clearly marked as unaudited, the auditor's report on the audited financial statements should be expanded to include a disclaimer on the supplementary information.

Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents

(Supersedes Statement on Auditing Standards No. 29, AICPA, Professional Standards, vol. 1, AU sec. 551.15.)

Supplementary Information Required by FASB or GASB Pronouncements

3. This amendment, by replacing paragraph 15 with a new paragraph 15, (a) recognizes the GASB's authority to require state and local governmental entities to present supplementary information, and (b) requires the auditor's report to be expanded when the auditor is unable to remove substantial doubts about whether the supplementary information conforms to FASB or GASB guidelines.

15. When supplementary information required by the FASB or GASB is presented outside the basic financial statements in an auditor-submitted document, the auditor should disclaim an opinion on the information unless he has been engaged to examine and express an opinion on it.⁷ The following is an example of a disclaimer an auditor might use in these circumstances:

The [identify the supplementary information] on page XX is not a required part of the basic financial statements but is supplementary information required by the (Financial or Governmental) Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Also, the auditor's report should be expanded in accordance with paragraph 8 of the section of this Omnibus Statement titled *Required Supplementary Information* if (a) supplementary information that the FASB or GASB requires to be presented in the circumstances is omitted, (b) the auditor has concluded that the measurement or presentation of the supplementary information departs materially from guidelines pre-

⁷ The guidance in subsection (b) of this paragraph applies to GASB required supplementary information, such as that required by GASB Statement No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers*. The auditor should refer to SAS No. 42, *Reporting on Condensed Financial Statements and Selected Financial Data* (AICPA, Professional Standards, vol. 1, AU sec. 552.09–552.10) for an example of a report on GASB required supplementary information.

scribed by the FASB or GASB, (c) the auditor is unable to complete the procedures prescribed by the section of this Omnibus Statement titled *Required Supplementary Information*, or (d) the auditor is unable to remove substantial doubts about whether the supplementary information conforms to prescribed guidelines.

Amendments in this Statement were adopted by the assenting votes of twenty-one members of the board, of whom one, Mr. Compton, assented with qualification to amendment number one to SAS No. 5, The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report.

Mr. Compton qualifies his assent to this amendment because he believes that the hierarchy of determination of generally accepted accounting principles does not reflect the reality of the interpretation of accounting principles by external regulatory bodies and self-regulatory bodies who regulate the profession, to whom the concept of due process does not have a similar meaning as that conveyed in this Statement.

Auditing Standards Board (1986–1987)

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Note: Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Conduct requires compliance with these standards.